Alternative Health Fund

September 2019 Commentary

Investment Team

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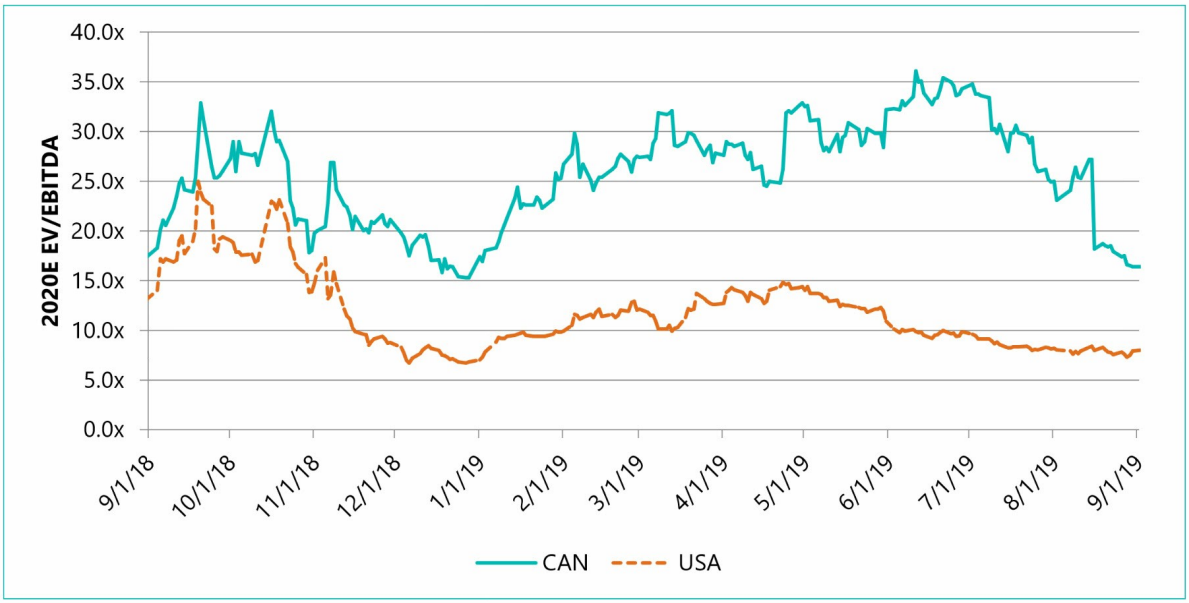
Over the last four months, the cannabis sector has witnessed significant downside. Selling has been widespread, sparing no participant. It has not mattered whether a company is meeting or exceeding its growth targets and cash flow projections (such as **Trulieve (TRUL)** or **Valens GroWorks (VGW)**)nor does it matter if a company is significantly behind its original guidance (Canopy or Aurora). Generally the Canadian LP's are off 50% while US Multi-State Operators (MSO's) are suffering similar weakness in equity values. During such times, our actively managed approach is focused on managing risk. As can be seen in our month end portfolio allocation, we maintain a healthy cash weighting that has been built up as we have reduced or eliminated cannabis positions that we believe are not core positions. We have also allocated capital towards our other sub-sectors. In addition, our option writing program is actively involved in writing puts on names that we don't mind owning at these weakened levels. Over the last three months, the Fund is down 17.01% relative to the passive HMMJ that is down 33.36%.

During the month of September, vaping bans dominated the headlines, causing investors to re-evaluate their growth expectations for many cannabis companies (discussed below). Some businesses were hit harder than others while expectations grew that Health Canada might delay the launch of Cannabis 2.0 in order to understand vaping risks better. Then, news on September 30th that BNY Mellon (Pershing) would stop accepting custody of US cannabis shares put further pressure on quotes as investors had to find alternative custodians. Within days, other large well-known custodians were gaining clients. We think it is odd that at a time when the SAFE Act was being approved in the House and appears to have momentum to pass the Senate (discussed below) that BNY Mellon was making this move to be more restrictive.

It is our view that the equity values of many of the leading names in the North American cannabis sector do not reflect the strength of the underlying businesses they represent. We note that in the spring the average of the US MSO's traded at a 60-70% discount to the average multiple for Canadian LP's. That discount persists in the 40-50% range. We continue to be focused on those companies in the US that are expanding their state by state platforms, building brands and expanding their wholesale and retail distribution. Despite a lack of federal legalization in the U.S., there is a much larger addressable market with companies able to advertise their products within the regulatory framework of each state. Under current regulations, Canadian companies do not have that ability.



Source: viii Capital

We believe that this is a compelling time to invest in the Ninepoint Alternative Health Fund. With the leading cannabis companies providing quarter-over-quarter revenue growth, and growing positive cash flows, the valuation entry points are very appealing. In addition, there are a number of upcoming catalysts that could push the sector higher including:

- Completion of Dept of Justice reviews for M&A transactions, clearing a path of uncertainty and allowing businesses to be combined and build national footprints;
- Additional high-population states such as New York, New Jersey, and Connecticut discussing harmonized rules for the introduction of adult use cannabis. Collectively these states represent a population of 32 million people;
- Introduction of Cannabis 2.0 in Canada;
- SAFE Act passage through the U.S. Senate.

Owning single positions in the cannabis sector can be problematic. Owning a portfolio of the leading names in an actively managed strategy has been a more stable approach to invest in this early stage sector. Yes there will be volatility to come as the sector develops around the world. For advisors and their clients, we believe a professional team that is analyzing the sector on a daily basis, finding the best value, the strongest growth potential all within a risk managed approach can add significant value over time.

Canadian Regulatory Challenges

September witnessed significant headwinds for the Cdn and US cannabis sectors despite some significant catalysts taking place in the US. North of the border, Ontario continues to have challenges opening dispensaries, the Provinces' most recent attempt thwarted by an injunction created by applicants disqualified in the lottery process. The group of applicants challenged their rejections and disputed the fairness of the procedures involved in the lottery that was used to grant Ontario's new 42 dispensary licences. As a result, lawyers argued, the commission was not entitled to disqualify the 11 applicants or to select a new slate of applicants to replace them. Lawyers representing the commission, however, said the eliminated applicants were to blame for emails bouncing back since they provided the address and chose that method of communication. In the end

an Ontario Superior Court judge ruled against the applicants, in favour of the Province and it is anticipated that the lottery process will continue.

Currently the most populous province in the country has 24 dispensaries open relative to Alberta that has an estimated 180 dispensaries already operating. The original plan was to open an additional 50 in anticipation of cannabis 2.0 launch, which is believed to be a strong business opportunity for LP's with higher value products with higher margins for products like chocolates, gummies and drinks. Any delay in retail distribution reduces the potential for revenue and cash flow enhancement at the Licensed Producer level.

CannTrust (TRST, CTST) announced that it received a Notice of Licence Suspension under section 64(1) of the Cannabis Act (Canada). The Notice cites the Company's non-compliance with certain requirements of the *Cannabis Act* (Canada). The Notice states that Health Canada has suspended CannTrust's authority to produce cannabis and sell cannabis. The Notice states that Health Canada will reinstate CannTrust's licences under section 64(4) of the Cannabis Act if the reasons for the suspension no longer exist or if CannTrust demonstrates that the suspension was unfounded.
We have also seen the negative news related to the vaping crisis flow over the border to drag those Cdn LP's down on expectations of changing regulations or outright bans. Officials in Ontario announced what they believed was Canada's first case of a vaping related illness. Currently, only cannabis extracts, concentrates, and whole flower or buds are legally available throughout Canada. Although Canadian regulators have not yet announced any delays or bans on vapes, *investigators initially suspected vitamin E acetate, a common skin-care additive that's often used to thicken black market vape oils, as the main culprit, however testing has shown other illicit market additives have also been linked to these sudden illnesses.*

US Regulatory Catalyst #1

Dept. of Justice HSR Review: A Positive Catalyst:
The announcement on September 10th that **MedMen (MMEN)** has successfully completed the Dept. of Justice (DOJ) HSR review is a meaningful catalyst for the US Multi-State Operators (MSO's). This transaction took over 200 days to clear DOJ reviews, significantly longer than the first transaction **iAnthus/MPX (IAN)** that closed in February. The delay lead to investor questions regarding approvals and as a result, US MSO equities have been weighed down in part by concerns that the DOJ would impede these transactions due to federal illegality. Acquisition spreads tightened significantly on September 10th, due to confidence that these large transactions will close. For the **Origin House (OH)/Cresco (CL)** transaction, OH was up 10.4% September 10th.

There are several positive implications for the US MSO's given this successful DOJ review.

The MMEN announcement reinforces our view that antitrust issues do not pose a material risk to deals closing, which should alleviate potential investor concerns over this matter. Rather, it would appear that the main focus of the DOJ is to gather information on cannabis operators in order to become more knowledgeable about the industry as various pieces of federal legislation, such as the SAFE Act and STATES Act go through Congress.

This is setting up timing goalposts for other M&A transactions in the industry, providing improved visibility for investors. We have already seen press releases from CL/OH stating that given the date of submission of their letters of compliance to the DOJ, clearance should be provided on or about October 17th. Harvest Health & Wellness (HARV) also press released that its acquisition of Falcon

(private) has also submitted its required letters and given the mandatory waiting period, clearance should be provided on our about October 23rd. Curaleaf (CURA) has also submitted its letters of compliance with respect to its acquisition of Select (Private) and given the timing, should receive clearance by early November. These should be positively received in the market.

US Regulatory Catalyst #2

The SAFE Act Passes in the House:
The SAFE Act passed the House of Representatives on a strong bipartisan vote of 321-103 on September 25th. This was a much stronger bipartisan vote out of the House than previously anticipated, giving momentum for the bill to pass the Senate and be signed into law. 91 Republicans voted for the measure, in a showing of strong bipartisan support. While hurdles remain in the Senate given Republican control, the strong House vote, coupled with the desire to provide hemp farmers similar access to federal financing, strongly supported by Senate Majority Leader Mitch McConnell (R-KY) as well as provide a legislative win to vulnerable incumbents such as Senator Cory Gardner (R-CO), should provide the political will to get the SAFE Act passed. The Bill is also written to appeal to Senate Banking Chairman Mike Crapo (R-ID) as it includes so-called Operation Choke Point language. This is designed to bar the government from pressuring banks to stop serving legal companies that might be out of political favor.

The essence of the SAFE Act opens state-legal cannabis and hemp processors to FDIC banking, credit card processing and insurance. It also allows landlords and REITs to own and work with cannabis related real estate assets. This decision is very helpful to cannabis and hemp companies by ensuring they have reliable access to basic financial services.

The bill – the first piece of cannabis legislation passed by either the full House or Senate – needed a two-thirds majority of those present and voting. For years, state-legal cannabis businesses have struggled to gain access to traditional financial services and products, hampering their operations and growth, and creating a significant public safety risk due to the cash intensive nature in what is now a multibillion-dollar-a-year industry.

FDA – CBD Guidelines to be Issued

Senate Majority Leader Mitch McConnell (R-KY) is moving to insert language into a congressional spending report that calls on the Food and Drug Administration (FDA) to clear a path for the lawful marketing of hemp-derived CBD products. The FDA has said that allowing CBD to be sold as food items or dietary supplements would require it to develop alternative regulations that could take years to complete without congressional action. But McConnell, who was the chief proponent of a hemp legalization provision of the 2018 Farm Bill, isn't interested in waiting around.

In draft language shared by the U.S. Hemp Roundtable, the senator is asking FDA to "issue a policy of enforcement discretion with regard to certain products containing CBD" within 120 days—a move that industry stakeholders say will clarify rules so that banks are more willing to service CBD companies.

US Regulatory Issues: Vaping

In the US, Federal and state health authorities are looking into at least 800 cases, (including 12 deaths) from 46 states of lung illness among people who have used e-cigarette devices, liquids, refill pods or cartridges. It appears the illnesses stem from inhaling a chemical substance that may have been unknown, a chemical additive or contaminant to vape oil which has been used by the illicit

market to cut or colour oil.

Vaping has been around for many years and until this summer had not caused a cluster of lung illnesses; nor has vaping caused illness in Britain, where it is tightly regulated. There are now warnings from the Centers for Disease Control and Food and Drug Administration: Young people should not use vaping products, nor adults who do not currently use tobacco, *and if you do vape, do not buy vaping products off the street.*

The vaping crisis is starting to show evidence of the black market being the problem. This "negative" for the industry could be a positive if US and Canadian regulators announce appropriate measures. It will also be a wake-up call to those consumers that rely on the black market to once again consider joining the regulated market for their supply, where unknown additives are not mixed into products.

This is like alcohol prohibition 100 years ago, people making bootleg booze in their basement then going blind. With the rise in lung illnesses investigators have done testing on various vape pens. In one set of tests in California, of the vape pens purchased from legal dispensaries in the state, the CannaSafe testing company found no heavy metals, pesticides or residual solvents like Vitamin E in legal vape pens. But 13 out of the other 15 samples from black market THC cartridges were found to contain Vitamin E. CannaSafe also tested 10 of the black market cartridges for pesticides. All ten tested positive. In addition, all black market products contained myclobutanil, a fungicide that can transform into hydrogen cyanide when burned. As stated, with awareness of the dangers of the black market, the regulated market over time is poised to gain from the stability and safety of its products.

On September 24th, Massachusetts Governor banned all vape sales for four months, all tobacco and cannabis related vape products due to recent illnesses. Governor Baker stressed that the ban is a pause to allow the medical community and federal officials time to investigate what's driving the spike in illnesses. While we understand the desire for governments to act, we believe this kind of regulatory action could end up making the crisis worse as more people are pushed to purchasing their vaping equipment on the black market. It is important to note that MSO's are not aware of any deaths related to products sold in the regulated market.

European Regulatory Catalyst:

On September 23rd, the European Medicines Agency (EMA) approved Epidiolex for use as adjunctive therapy of seizures for patients 2 years of age and older. The approval paves the way for the launch of the medicine across Europe, which is estimated to have a direct patient need related to Dravet syndrome and LGS of ~46,750. Given the stronger than expected revenues last quarter, it is anticipated that Europe could amount to 20% of overall sales.

US Mergers & Acquisitions

Cresco Labs CL continued its expansion with the acquisition of NV based Tryke Companies, giving CL approximately 8% market share in Nevada, a huge boost to CL's presence in Arizona, along with access to a 12th state, Utah as Tryke's recent receipt of one of eight cultivation licenses in the state. CL is currently active in 11 states accounting for 70% of the U.S. population. NV is a large market given its medical and recreational focus, combined with the significant amount of annual tourists to the Las Vegas strip. Tryke owns 4 REEF dispensaries in NV including its flagship store across the street from the Planet 13 Superstore. To date, REEF has not generated the daily customer traffic or average revenue per customer however with CL's leadership, there will be more competition on the strip. Arizona is one of the largest medical-only markets in the U.S. with more than 210,000

registered patients with the majority of the state's population located in Phoenix, the 5th most populous city in the U.S. We understand that Arizona is expected to have an initiative on the 2020 ballot to legalize adult-use sales.
The purchase price is approximately US$252.5 million for Tryke operating assets plus US$30 million for Tryke real estate assets composed of cash and CL stock.

Curaleaf (CURA) News:

During September MKM, a New York **brokerage firm** issued a negative research report on CURA which in review only focusses on its Florida business and does not take into account pending acquisitions or states where CURA currently operates. In our opinion, MKM offers a very weak explanation of why they don't like the company.

The report states that FLA market is becoming increasingly competitive, and that CURA's store metrics are below average. CURA is tied for the #2 market share position in the state in terms of sales volumes of non-smokable products (13% share), and the #3 market share position in terms of smokable products with 16% share.
At a time that other competitors have reduced capital expansion in FLA only **Trulieve TRUL** and **CURA** have reiterated growth plans to add stores in this market. As a result, CURA will be in a position to build out its business in FLA while others are committing capital elsewhere. FLA is a growing medical market and CURA will be able to maintain its top 2-3 status.

We would also point out that CURA is in the Top 3 in several other state markets. They are #1 market share in New Jersey and this was not mentioned in the MKM report. Also CURA's Grassroots (private) acquisition would add top 3 market share positions in Illinois and Pennsylvania as well. These are all solid markets, and CURA would be the only publicly traded MSO with a top 3 market position in these 4 meaningful states. In Iliinois, the medical only state is about to allow adult recreational use Jan 1 and incumbents (Grassroots) will have an advantage to open stores early, along with GTI and CL.

Option Strategy

During September the Fund continued using its option strategy to enhance risk adjusted returns. With the above average volatility in the cannabis and associated health care sectors, we are able to generate significant option premium, while lowering the overall volatility of the Fund relative to its underlying benchmark. Since inception of the option writing program in September 2018, the Fund has generated significant income from option premium of over $2.1 million.

During the month we used our option strategy to assist in rebalancing the portfolio in favor of names we prefer while generating an impressive $85,000 in option income. We continue to write covered calls and strangles on names we feel are range bound near term and from which we could receive above average premiums. Examples of such trades include Canopy Growth (CGC) and Procter & Gamble (PG). During the month, we were able to write cash secured puts out of the money at strike prices that offered opportunities to increase our exposure, at more attractive prices, to names already in the Fund including United Health (UNH) and a new name for the Fund, Innovative Industrial Properties Inc (IIPR) with cash secured puts on IIPR having been especially rewarding. We have been able to take advantage of both the recent price correction and elevated volatility to write cash secured puts on Innovative Industrial Properties Inc, the leading provider of real estate capital for the medical-use cannabis industry in the United States. Explained below is the summary of a

trade on Innovative Industrial Properties for the month of September.

Innovative Industrial Properties provides real estate capital for the medical-use cannabis industry in the United States by entering into sale and leaseback agreements with companies that require expansion capital They target initial yields in the mid-to-low teens provided by absolute triple net long-term leases with annual escalations of 3-4%. We established an initial half a point position but are now focused on option writing to accumulate further shares. On September 23rd IIPR was trading at USD $96.07 and we wrote a 25 day cash covered put by selling an October 18th expiry at the volatility level of 43% with strike price USD$95.00 and earning USD$4.20. That equates to a strike yield of 4.42% for 25 days outstanding or the equivalent of 63% for a year. The breakeven for being assigned would be USD$90.80 or 5.49% lower than the reference point when the trade was placed. As of the date of this writing IIPR trades between USD $89 and $95 level and we are happy to continue this strategy at these levels as IIPR negotiates additional investments for both new tenants and expanding partnerships with existing tenants.

The Ninepoint Alternative Health Fund, launched in March of 2017 is Canada's first actively managed mutual fund with a focus in the cannabis sector and remains open to new investors, available for purchase on a daily basis. Utilizing our actively managed approach we have been able to generate industry leading risk adjusted returns.

Charles Taerk & Douglas Waterson
Portfolio Team
Ninepoint Alternative Health Fund

Compounded Returns[1]

	1MTH	3MTH	6MTH	YTD	1YR	INCEPTION
FUND	-8.2	-17.0	-26.0	-2.4	-20.3	28.1
INDEX	-4.94	-20.00	-25.34	-3.19	-27.59	11.21

Statistical Analysis

	FUND	INDEX
Cumulative Returns	70.7%	25.61%
Standard Deviation	31.81	33.53
Sharpe Ratio	0.85	0.30

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at September 30, 2019. The index is 70% Thomson Reuters Canada Health Care Total Return Index and 30% Thomson Reuters United States Healthcare Total Return Index and is computed by Ninepoint Partners LP based on publicly available index information.

The Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these risks: Cannabis sector risk • Currency risk • Cybersecurity risk • Derivatives risk • Exchange traded fund risk • Foreign investment risk • Inflation risk • Market risk • Regulatory risk • Securities lending, repurchase and reverse repurchase transactions risk • Series risk • Specific issuer risk • Sub-adviser risk • Tax risk

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